

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Paul Webber on May 11, 2006
Follow-up phone call on May 15, 2006

DATED: June 10, 2006

On May 11, 2006, Michael Schachter and Raymond Sarola, in Willkie Farr & Gallagher LLP's capacity as Counsel to the Audit Committee, and Troy Dahlberg of the Audit Committee, interviewed Paul Webber. Mr. Webber was represented during this interview by George Garvey and Dean Kawamoto, of Munger Tolles & Olson LLP. Also present were Rahul Khona and Eric Bell of KPMG, and Dan Tyukody of Orrick, Herrington & Sutcliffe LLP. This interview took place in a conference room in the law offices of Munger Tolles in Los Angeles and lasted approximately five and one-half hours. There was a follow-up phone call on May 15, 2006, which lasted approximately fifteen minutes. Benito Romano, Michael Schachter, Sharon Blaskey, and Raymond Sarola of Willkie Farr & Gallagher LLP, along with Paul Webber and his attorney George Garvey were in attendance for this call.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Mr. Webber, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Schachter explained that the interview was on behalf of the Audit Committee and that there was no privilege covering the interview. As a result of the City's lawsuit against Orrick, Mr. Webber declined to discuss matters relating to that suit or the pension system generally; Mr. Webber would only discuss matters relating to the wastewater financings. In addition, Mr. Webber was directed by the City's outside counsel, Cooley Godward LLP, to assert the City's attorney-client privilege for any matters occurring after February 12, 2004. Mr. Webber honored this direction.

Role of Disclosure Counsel

Mr. Schachter began the interview by telling Mr. Webber that he wanted to discuss the role of disclosure counsel generally. He instructed Mr. Webber to answer these questions in the wastewater context only, so as to abide by the privilege limitations of this interview. Mr. Schachter asked Mr. Webber what was the first bond offering for the City of San Diego in which he was involved. Mr. Webber responded that he was first retained as bond counsel for the 1993 wastewater offering. Mr. Schachter asked if the City had issued debt before

1993 and Mr. Webber replied that the City issued debt in the 1960's, but that 1993 was the first offering in which he was involved. Mr. Schachter asked Mr. Webber to explain the City's purpose in going to the debt market to raise funds. Mr. Webber explained that the City had entered into a consent decree with the United States Attorney's Office in which it agreed to upgrade the quality of sewage disposal at the Point Loma facility. This upgrade triggered a major financing program.

Mr. Schachter asked if this offering was his first engagement in any capacity with the City of San Diego. He responded that it was, and that Orrick was only retained as bond counsel for this deal, not disclosure counsel. For the 1993 offering, the underwriters had counsel, but the City did not have disclosure counsel. Mr. Schachter then asked Mr. Webber to explain the different roles held by bond counsel and disclosure counsel. Mr. Webber stated that bond counsel are responsible for developing the structure of a financing and ensuring the availability of state and federal tax exemptions. Disclosure counsel are responsible for giving a 10b-5 opinion on the disclosure documents. Mr. Webber noted that underwriter's counsel also give an opinion on the offering. Mr. Schachter then asked Mr. Webber to describe the substance of the disclosure counsel's opinion. Mr. Webber replied that it is similar to a '33 Act opinion and that the thrust of the opinion is that the disclosure counsel has sat in on discussions with the issuing body and nothing in those discussions has led them to believe that the disclosure documents omitted material facts or misstated material facts, with the exclusion of financial data. Mr. Schachter asked why financial data was excluded, and Mr. Webber replied that disclosure counsel are not accountants and do not check the demographic data of the municipal issuer. Mr. Schachter asked to what portions of the disclosure documents the disclosure counsel's opinion applied and Mr. Webber answered that this opinion applied to the description of the operation of the issuer's enterprise and litigation concerns.

Mr. Schachter asked Mr. Webber to explain the role of underwriter's counsel. Mr. Webber stated that, at least regarding the 1993 offering, underwriter's counsel would have given a 10b-5 letter to the underwriters which would have stated that nothing had come to their attention to lead them to believe that the disclosure omitted material statements or misstated material facts.

Mr. Schachter asked if there were any other responsibilities within the role of disclosure counsel, and limited his question to Mr. Webber's experience with the City's wastewater offerings. Mr. Webber replied that disclosure counsel would discuss with the City the project to be undertaken, the business underlying that project (here, a wastewater plant), the recipient of services provided (here, retail, industrial, and wholesale customers), and assist the City in drafting a document that includes all information they feel is material based on the foregoing discussions. Mr. Schachter asked if it was his practice to rely on the information that the City communicated to him, or if he performed his own investigation or audit. Mr. Webber replied that he certainly did not engage in auditing. He stated that the extent of his reliance would be determined by the information he was told. By way of example, Mr. Webber stated that regarding the need to disclose litigation matters, he gave the City instructions to inform him of lawsuits affecting revenue streams or within certain financial parameters, and then assisted the City in the drafting of these disclosures. Mr. Webber noted that for the wastewater offerings, the largest litigation concern was compliance with the CWA (Clean Water Act). He stated that

Orrick relied heavily on Ted Bromfield (former Assistant City Attorney) to explain why the City was taking certain actions related to the CWA.

Mr. Schachter asked if when Mr. Webber was first involved with a wastewater offering, it was a larger undertaking than later offerings. Mr. Webber responded that this was not necessarily true. For instance, he noted that Orrick did not give a 10b-5 opinion in the first financing, because they were only bond counsel for this offering. Mr. Schachter then asked who drafted the regulatory requirements section of the 1993 disclosure. Mr. Webber first responded that by this time, Orrick was disclosure counsel and the author of this section would have been Ted Bromfield or a woman named Peggy. Mr. Garvey then asked Mr. Webber if he wanted to check the dates of his last comment. Mr. Webber clarified that Orrick was not disclosure counsel in 1993; they only became disclosure counsel in 1995.

Disclosure Procedure Generally

Mr. Dahlberg asked Mr. Webber to name the people at the City who composed the team with whom he worked as disclosure counsel. Mr. Webber explained that early on, he worked with Sherri Saks (phonetic), and then Dennis Kahlie (Utilities Finance Administrator) in the Finance Department. Christine Ruess later joined the team as an assistant to Mr. Kahlie. Mr. Webber stated that there were also operations people on the team, such as Bill Hanley (Deputy Director for Contract Services, MWWD) and Dave Schlesinger (MWWD Director), and representatives from the Auditor and Comptroller's Office, such as Ed Ryan (City Auditor), Ed Wochaski (Principal Accountant, Auditor's Office), and Terri Webster (Deputy City Auditor). Mr. Dahlberg asked if all three of those accountants attended these meetings, and Mr. Webber replied that they did not attend at the same time, but he recalled interaction with all of them over the course of his representation of the City. He stated that Mr. Bromfield was the "common denominator" throughout this time. He also mentioned Margaret Strand (General Counsel for San Diego County Water Agency), Curtis Fitzpatrick and Kelly Salt from the City Attorney's Office, and Mary Vattimo (City Treasurer), who was "at the top of the heap" on the finance side.

Mr. Dahlberg asked Mr. Webber if he educated these individuals on what information he needed from them. Mr. Webber responded that the process started with the document from the prior offering. These were very large meetings with many people conferenced in by telephone, and Mr. Webber would break down the OS (Offering Statement) into sections for preparation. He mentioned that Mr. Hanley, for example, would be given the sections related to operational matters and the description of projects. Mr. Webber stated that Mr. Hanley and Mr. Schlesinger were "key" from the operations perspective. He would assign the section regarding projections and historical financial data to a representative from the Finance Department. He noted that by 1997, the City stopped using financial advisors for its feasibility projections and ran these projects itself. The Head of Investments would be responsible for the investment pool description, and the Finance Department might have been responsible for the pension section. Each of these sections would be updated by the individuals responsible and returned to Mr. Webber. There would be discussions and questions between Mr. Webber and these individuals throughout the process. Mr. Webber thought that they were very good at bringing up issues and stated that Orrick relied heavily on them. Once the sections had gone through two or three drafts, Mr. Webber would try to put them all together in one book. He noted that there was not much that needed to be updated in the section describing the bond itself.

Mr. Dahlberg then asked if Mr. Webber believed that these individuals understood that disclosure was a serious issue. Mr. Webber stated that he would have "come to Jesus" meetings where he pointed out the risks in the underwriter's agreement, for instance. He explained that if the City omitted material facts they would face regulatory or litigation exposure. Mr. Webber stated that he gave these individuals examples of issues that needed to be disclosed, such as when the Council got the City Attorney's Office to revoke the consent decree in 1991 because the Council did not want to upgrade to secondary treatment. Mr. Dahlberg asked if he thought these individuals had a reasonable education on these matters, and Mr. Webber responded that he believed they did.

Interaction with City Officials

Mr. Dahlberg asked Mr. Webber if he interacted with the City Manager during his representation of the City. Mr. Webber responded that he did not see much of Jack McGrory or Michael Uberuaga, since he dealt primarily with Pat Frazier (Deputy City Manager) and those beneath her. Mr. Dahlberg asked if he thought she was knowledgeable and he responded that he thought she was, but that she was a "bigger-picture person." Mr. Webber stated that on a day-to-day basis, he interacted with Ms. Vattimo, Ms. Salt, Mr. Kahlie, Mr. Bromfield, Mr. Ryan, Ms. Webster, and Mr. Fitzpatrick, and that they were all knowledgeable. If Mr. Webber had any administrative issues, he stated that he would go to Mr. Fitzpatrick because of his history with the City and good relationship with the Mayor and Mr. McGrory.

Mr. Dahlberg asked Mr. Webber to explain Mr. Fitzpatrick's role, and he replied that Mr. Fitzpatrick was the City Attorney and that he was the person who hired Mr. Webber. Mr. Webber stated that he retired in 1997 or 1999 and was in private practice when he died. Mr. Webber stated that Mr. Fitzpatrick could always get issues straightened out and could "read the Riot Act" even to senior officials in the City.

Mr. Dahlberg asked about the role of the City Manager's Office in bond offerings and Mr. Webber replied that it did not have much of a role. Mr. Dahlberg asked about the role of the City Council and he replied that supposedly Council members reviewed disclosure documents because they ultimately approved them. Mr. Dahlberg asked if Mr. Webber attended Council meetings and he replied that he attended them from time to time. Mr. Dahlberg asked if he thought the Council understood its responsibility. At this point in the interview, Mr. Garvey asked for a break.

After a five-minute break, Mr. Garvey stated that Mr. Webber would not discuss the attitudes of Councilmembers or Council procedure, with the exception of one observation. Mr. Webber stated that prior to the Orange County bankruptcy and resulting 21A report, governing bodies of public agencies were not very involved in reviewing disclosure documents, and had the disclosure approval process on their consent calendars. Items on the consent agenda were not viewed as controversial; they were read off by the Council Clerk and were never discussed. The San Diego City Council approved disclosure documents on the consent calendar before the Orange County bankruptcy. Mr. Webber believed that sometime in the late 1990's, the Council changed this procedure and took the approval of disclosure documents off the consent agenda so it could be discussed.

1993 Offering

Mr. Webber was then shown the 1999 Sewer Revenue Bonds Official Statement (Exhibit 1), and was instructed to read the last paragraph on page 22 to page 23. Mr. Webber stated that he was familiar with this document. Mr. Schachter directed him to the language in the Official Statement ("OS") stating that the City's rate structures have not been disallowed, and asked who wrote this section. Mr. Webber stated that he did not write this and he believed Mr. Bromfield did.

Mr. Schachter asked if this same language was in the 1993 Offering and Mr. Webber responded that it was. Mr. Webber stated that there was underwriter's counsel for this deal, but no disclosure counsel, and it was the responsibility of underwriter's counsel to review the regulatory requirements section. Mr. Schachter asked if Mr. Webber recalled any discussions around the time of the 1993 Offering on the subject of regulatory requirements, and Mr. Webber responded that he did not.

Mr. Schachter asked Mr. Webber to explain the basis for his belief that Ted Bromfield authored the regulatory requirements section of the 1993 disclosures. Mr. Webber stated that there was an earlier attempt at a financing in 1990 or 1991 and at that time there was no underwriter. The offering was done by competitive bidding and the disclosure document (in draft form) was literally drafted by Brigsby Branford (phonetic), a financial advisor. They were "mechanically retaining" the document, but Mr. Webber believed, "through surmise at this point," that Mr. Bromfield drafted and was responsible for the accuracy of this document. Mr. Schachter asked if Mr. Webber had any documents on this issue and he replied that he did not. Mr. Schachter asked whether, as bond counsel, Orrick would have discussed the regulatory requirements section or the status of grants and loans from the state or federal governments, and Mr. Webber replied that Orrick certainly would not have reviewed these items in 1993.

1995 Offering

Mr. Schachter turned next to the 1995 Offering and began by confirming with Mr. Webber that Orrick was the City's disclosure counsel for this offering. Mr. Schachter then asked if he did anything to verify the appendices to the offering documents. Mr. Webber responded that he would have looked at some but not all of the appendices. He explained that he would not have looked at the appendices that pertained to financial data or demographics, but would have drafted the section which described the bond and the bond documents. He noted that Orrick would not have given an opinion on the demographic information or on any projections or feasibility studies, which would have been handled by an engineering firm. He stated that his review of the appendices was "pretty limited except for the description of the securities."

Mr. Schachter asked if he reviewed the City CAFR (Comprehensive Annual Financial Report) or the Wastewater Annual Report, and he replied that he did not.

Mr. Schachter asked if there was a signed opinion which accompanied the issuances and Mr. Webber replied that there was a bond counsel opinion, which was a part of the appendices that he would have reviewed. He explained that this opinion was delivered at closing and was not a part of the disclosure documents. The underwriter would get a supplemental opinion that commented on certain sections of the disclosure, and if Orrick served as disclosure

counsel they would have provided both the City and the underwriter with a 10b-5 opinion. Mr. Schachter asked if that 10b-5 opinion specifically carved out disclosure, and Mr. Webber replied that it would have.

In the context of the 1995 Wastewater Offering, Mr. Schachter asked who Mr. Webber spoke to about the regulatory requirements section of the disclosure. Mr. Webber explained that he divided up the disclosure document from the prior deal and assigned sections to various people to update. The regulatory requirements section was assigned to Mr. Bromfield because he was Mr. Webber's "go-to person for any regulatory matter relating to wastewater." Mr. Webber noted that the big issues at this time were the CWA and compliance with the consent decree. Mr. Webber stated that Mr. Bromfield was in charge of these issues and understood the litigations involved. Mr. Bromfield was responsible for this section in all issuances, not only in 1995. Mr. Webber stated that Mr. Bromfield made many changes to this section, and explained his changes to Mr. Webber.

Mr. Schachter asked if, as disclosure counsel, Mr. Webber read the entire disclosure statement, and he replied that he did. Mr. Schachter then asked whether he specifically recalled reading the language about the City's rate structure not being disallowed. Mr. Webber stated that he recalled reading this language and that "nothing jumped out at" him. He believed that in 1995 he made the City add an additional sentence to that section because of an issue regarding interfund transfers. Mr. Webber explained that the enterprise fund was engaged in the business of selling sewage and as such, it was required to have rates that related to the services rendered. Mr. Webber stated that he was becoming aware that public agencies were trying to get money out of the enterprise funds, and were finding legitimate ways to accomplish this. One approach was to determine that a percentage of police or fire salary related to the enterprise funds and use those funds to pay that amount. When he learned of this practice, Mr. Webber raised this issue and found out that the state had also raised this issue, so the City had to make a disclosure regarding this practice. Returning to the language in the document, Mr. Webber stated that because he had a high degree of confidence in Mr. Bromfield, the sentence regarding the City's rates not being disallowed did not jump out at him.

Mr. Schachter asked if Mr. Webber recalled any discussions with anyone regarding the City's need to allocate the costs of sewage services in a manner that complied with the requirements of loans and grants. Mr. Webber responded that he did not recall any such discussions and that he relied heavily on Mr. Bromfield to inform and educate him on matters relating to regulatory requirements. Once Mr. Bromfield educated him, he would then suggest what needed to be disclosed. Mr. Schachter asked if it was correct that nothing about this compliance issue attracted his attention in 1995, and Mr. Webber responded that this was correct.

1999 Offering

Mr. Schachter asked Mr. Webber about his interaction with the City Council regarding the 1999 Wastewater Offering and Mr. Webber replied that he had no interaction with the Council at this time. Mr. Schachter asked if he was present when the Council approved the disclosures and he replied that he might have been present but he could not say with certainty because the City was involved in a number of financings at that time. He did not recall having to answer any questions at any Council meeting about disclosure. Mr. Schachter asked if he ever spoke about disclosure to the Council in closed session and Mr. Webber responded that he did

not in the wastewater context and that a more complete answer would reach outside the boundaries of this interview.

Mr. Schachter asked if he recalled going before the Council in June or July of 2003 concerning the wastewater offering. Mr. Webber responded that he was virtually certain that he attended this meeting and that there was no discussion by the Council about disclosure. Mr. Dahlberg asked if Councilmembers questioned other City employees who were involved in the disclosure process at this meeting, and Mr. Webber replied that there might have been questions about the use of proceeds, but not about disclosure. He stated that this was more of a business discussion about the use of the proceeds and timing and that there was a political issue about rates going up.

Returning again to the 1999 issuance, Mr. Schachter asked if Mr. Webber recalled any discussion about proportional rate setting with Mr. Kahlie or Ms. Salt with regards to the CWA, and he replied that he did not recall any such discussion. Mr. Schachter asked if proportionality under the CWA was an issue that he focused on before the 1999 issuance. Mr. Webber responded that he did not, and stated that Mr. Bromfield would take each section of the disclosure after they were updated and "massage" them, by which he meant that Mr. Bromfield would mark up the old versions. Mr. Webber stated that in addition he would ask Mr. Bromfield on each deal if there was anything additional that the City needed to disclose because he knew Mr. Bromfield to be knowledgeable and forthcoming. Mr. Webber stated that in no instance did Mr. Bromfield reply that there was a problem with proportionality under the CWA or grants or loans.

Mr. Schachter then asked Mr. Webber if he had an understanding at that time of the magnitude of the grants and loans the City had received. Mr. Webber responded that he knew that the loans were in the hundreds of millions of dollars. Mr. Schachter then asked, putting aside SRF (State Revolving Funds) agreements, what steps Mr. Webber took from a disclosure perspective to determine the requirements attached to the receipt of loans and grants. Mr. Webber responded that other than relying on Mr. Bromfield, he did nothing in this regard. Mr. Webber noted that Mr. Bromfield never marked up the paragraph in the disclosure that dealt with this issue, and that he would always ask Mr. Bromfield if there was any other risk of financial exposure to the City, and Mr. Bromfield never said anything about loans or grants.

Mr. Schachter asked Mr. Webber to describe the discussions he had with City officials in 1996 concerning the need to disclose Proposition 218 issues. Mr. Webber explained that he had discussions with Ms. Salt, Mr. Kahlie, and probably Ms. Vattimo. He informed them that Orrick had been discussing this issue with other municipal issuers since Proposition 218 impacted all entities that had enterprise funds. He gave them examples of disclosure language used in other California jurisdictions and told them "something along the lines of this has to be included." He noted that this issue was particularly sensitive because of a covenant which required the issuer to fix rates and charges in multiples of one (1.1, 1.2, 1.3, etc.) of debt service coverage. He discussed with the City whether this requirement raised Proposition 218 issues, but it was not clear if these were property-related charges. Mr. Webber stated that he did not get much argument about the need to make these Proposition 218 disclosures, even with the issue of the proportionality of the City's rates unsettled.

Mr. Schachter asked if Mr. Webber inquired further about the City's process for setting rates, and he replied that he did not and that the City was better informed than Orrick was about this process. He stated that in San Diego's case, they "talked a good game," and seemed to know exactly what they were doing regarding issues related to suspended solids and proportionality. Mr. Schachter then asked what the City discussed with him relating to suspended solids. Mr. Webber referred to Table 8 on page 34 of the 1999 Sewer OS (Exhibit 1) and stated that a reading of this table led him to believe that the City had a charge for suspended solids. Mr. Schachter asked if he understood that charging for suspended solids meant "proportional," and Mr. Webber responded that the language on page 22 of the OS references strength of sewage and he understood this to mean suspended solids. Mr. Schachter then asked if he knew which offering was the first to include the language on page 22 referring to strength of sewage. Mr. Webber stated that this language was not in the 1995 offering and he did not recall if it was in the 1997 offering. He noted that he did not write this section; Mr. Bromfield would have written it. Mr. Schachter asked if he discussed this language with anyone and Mr. Webber replied that he did not. Mr. Schachter asked if he discussed with anyone whether billing on account of suspended solids meant that the rates were proportional. He responded that he did not discuss this with anyone and that he inferred this understanding from the language itself. He did recall that City officials told him that the City billed proportionally under Proposition 218. Mr. Schachter asked if he was told specifically that the City billed proportionally because it billed for suspended solids and Mr. Webber replied that he was not told this. Mr. Webber then noted that the City made a Proposition 218 disclosure in their supplemental disclosures. Mr. Schachter asked if the City believed that Proposition 218 did not apply to sewer charges. Mr. Webber responded that he didn't know if the City went that far. Mr. Webber stated that the *Shasta* case suggested strongly that sewer rates were land-based charges, and that this issue arose again in the 2003 financing.

Mr. Schachter then asked Mr. Webber if he remembered informing City officials in 1997 of the risks of nondisclosure. Mr. Webber responded that he told City officials that it was not clear if sewer rates were land-based fees or charges, and that it was his recommendation to disclose this uncertainty and justify the conclusion that the City nonetheless complies with the requirements of Proposition 218. He stated that Ms. Salt informed him that the City could justify this position, and he believed that Mr. Kahlie told him this as well. Mr. Webber stated that he did not remember having this discussion again in 1999.

Mr. Schachter asked Mr. Webber if he had Mr. Bromfield's mark-ups of the disclosure documents in his files and Mr. Garvey responded that he would look for them. Mr. Schachter stated that it would be useful to the Audit Committee to determine how changes to this language were made.

Mr. Schachter then asked Mr. Webber if he was informed in 1999 of the non-compliance of the City's rates with the requirements of loans and grants, and he replied that he was not. Mr. Schachter asked if Mr. Webber was aware that in 1995 or 1996, the City changed how it billed participating agencies, but did not change its municipal rates. Mr. Webber replied that he was not aware of this. Mr. Schachter next asked if he was ever informed that the City changed the rate structure for participating agencies. Mr. Webber replied that he was not informed of this, other than his being told in 1991 or 1993 that the City needed to change its rates to attain the necessary coverage for its bond service. Mr. Schachter asked if these discussions

involved the City's rate structure and Mr. Webber replied that they did not. Mr. Webber stated that he did not know that there was a different rate structure for participating agencies and the municipality, and did not know that an outside consultant prepared a report that concluded that the City was not in compliance with the covenants of grant and loan agreements. Mr. Schachter asked if it was possible that the City told him that they had a Cost of Service Study ("COSS") performed but he did not understand what the significance of this term. Mr. Webber responded that the City did not tell him anything along these lines until 1999.

Mr. Schachter asked Mr. Webber at what point during the disclosure process he would have expected to have been informed about the City's non-compliance with loan and grant covenants. Mr. Webber first responded that a report by City Attorney Michael Aguirre mentioned a memo from the City Attorney to Mr. Bromfield in November 1999 suggesting that there was an issue of non-compliance. In addition, he noted that Councilmember Christine Kehoe made a request to bring rates within compliance of Proposition 218. Mr. Webber stated that he would have expected Mr. Bromfield or Councilmember Kehoe to inform him of these issues. Mr. Schachter then restated his question, explaining that he wanted Mr. Webber to tell him at what point in time he would have expected someone to have told him about the non-compliance issue. Mr. Webber explained that when he handed the section of the disclosure document that covered regulatory requirements to Mr. Bromfield for revisions, he would always ask Mr. Bromfield if there was any other material information he should know about. Mr. Webber stated that any responses Mr. Bromfield gave him did not involve sewer rates. Mr. Schachter asked him to describe the nature of these conversations, and he replied that they were normally phone conversations held when Mr. Webber was reviewing the section that Mr. Bromfield updated.

Mr. Schachter asked if Mr. Webber recalled conversations regarding the paragraph in the disclosure dealing with the City's sewer rate structure not being disallowed. Mr. Webber responded that he did not recall discussions on that paragraph, but stated that he could provide to Mr. Schachter markups of Mr. Bromfield's section where he did not modify that paragraph. He stated that at the time of these markups, he would have asked if there was any other disclosure that should be made regarding this section. Mr. Schachter asked if, aside from these phone calls with Mr. Bromfield, there were other times he would have expected a City official to mention this issue. Mr. Webber replied that he would have expected someone to tell him during discussions regarding Proposition 218. Discussions on Proposition 218 began during the 1997 financing, when Orrick explained its view that the City needed to disclose this issue. Orrick made suggestions and revised draft language, and ultimately told the City that it should disclose that its rate structure complied with the requirements of Proposition 218, one of which was proportionality. Mr. Schachter asked who he discussed this issue with, and Mr. Webber responded that these discussions were with Ms. Salt and Mr. Kahlie.

Mr. Schachter asked Mr. Webber to explain "page-turner" meetings. Mr. Webber responded that these meetings were held once the disclosure document had been re-assembled in substantial part, and was in a form in which it could be reviewed as a single document. He stated that Ms. Salt would make grammatical changes during these meetings. They were called "page-turner" meetings because Mr. Webber would literally turn each page and ask if anyone had any comments on that page before moving on. Mr. Webber stated that this would not have been the

time to raise the issue of non-compliance because this should have been discussed at earlier stages in the process, so he did not recall any mention of this issue during these meetings.

Mr. Schachter asked Mr. Webber at which point in the process he gave his speech regarding the importance of accurate disclosure. Mr. Webber stated that he would have given it to the City in prior years. He noted that financial advisors and underwriters attended page-turner meetings and he would not have given his speech in that context. Mr. Schachter asked what would happen when there were new people attending these meetings who had not heard the speech before. Mr. Webber responded that Ms. Salt, Mr. Ryan, Mr. Kahlie, Ms. Vattimo, Mr. Fitzpatrick and Mr. Bromfield were there for all financings. Mr. Schachter asked Mr. Webber if he only gave this speech once, and he responded that he gave it at least twice. He stated that he gave it first at the 1999 financing when he was explaining the underwriting agreement, and that he would have given the speech to Ms. Salt on other occasions as well. He explained that he went to Ms. Salt to ask who he should speak to regarding litigations, and would have given her parameters to define the types of litigations that he was interested in, such as those that challenged the financial condition of the enterprise fund. He stated that Mr. Fitzpatrick got this speech early on, and there was no reason for him to repeat it.

Returning to the discussion of litigation matters, Mr. Schachter asked Mr. Webber to describe the setting in which he asked Ms. Salt for information about this issue. Mr. Webber stated that he would discuss litigation issues with Ms. Salt when he gave her litigation assignments to be handled by the City Attorney's Office. Mr. Schachter asked Mr. Webber to describe the thresholds that he gave Ms. Salt to determine which litigation was material. Mr. Webber responded that in 2003, he told her to inform him of every claim for \$10 million or more that was not insured or where the insurance company reserved its rights, any challenges to receipts or exchanges, or any disputes with the agencies to which the City provides services. Mr. Webber stated that Ms. Salt knew what he was looking for and why; he was interested in anything that would have a material impact on the enterprise fund's ability to make payments.

Mr. Schachter asked Mr. Webber to describe the setting in which he gave warnings about the importance of disclosure. He responded that he informed City officials of this one at a time. He stated that he discussed this by phone with Ms. Salt and Mr. Fitzpatrick (if he was available), and would have held a separate call with Mr. Bromfield. Mr. Schachter asked if he ever discussed with Mr. Kahlie what items needed to be disclosed. Mr. Webber responded that he did not have a separate recollection of this conversation with Mr. Kahlie. He stated that when original assignments for sections of the disclosure documents were handed out, he would have explained the information he was looking for. For example, Mr. Webber referenced page 15 of the 1999 OS (Exhibit 1) and stated that he would have given this section to Mr. Hanley. He would have called Mr. Hanley on a conference call with the disclosure team and told him to update the section with any changes that were relevant. Mr. Webber noted that he assigned the regulatory requirements and CWA section to Mr. Bromfield, the capital improvements section to Mr. Bromfield and Mr. Kahlie, the financial operations section to Mr. Ryan and Ms. Webster, and the section on rate information to Mr. Kahlie and Bruce Herring (Deputy City Manager). After these updates were made, Mr. Webber would compare them to the originals from the prior deal and ask why changes were made.

Mr. Schachter asked Mr. Webber if he paid particular attention to the City's compliance with grant and loan obligations or if he viewed this as a GASB issue. Mr. Webber

responded that this was a focus of the regulatory requirements section, and noted that Mr. Bromfield did not alter this paragraph. Mr. Schachter asked if it was possible that Ms. Salt did not interpret Mr. Webber's request for litigation information from her to include compliance because at the time he asked the State had not demanded compliance under threat of litigation. Mr. Webber replied that this conclusion would not have solved the City's problem because they eventually entered litigation over this issue. He further stated that he would not speculate on what Ms. Salt might have thought. Mr. Schachter asked if he posed his question to her in terms beyond "litigation," perhaps to include "compliance with loans and grants." Mr. Webber responded that he did not ask the question this way. Mr. Schachter asked if he used the phrase "not in compliance with regulatory requirements," and he responded that he asked that question of Mr. Bromfield but not of Ms. Salt because she would not have known the answer. Mr. Schachter asked if his contact at the City Attorney's Office ever changed from Mr. Bromfield to someone else, and Mr. Webber responded that it was Mr. Bromfield through 2003. Mr. Schachter asked if Ms. Salt was the person he would ask about litigation, and he responded that she was.

Mr. Schachter resumed the interview by directing Mr. Webber to look at page 31 of the 1999 OS (Exhibit 1), and read the section titled "Total Allocation for Billing Purposes." Mr. Schachter asked if Mr. Webber had reviewed this section in the past, and he responded that he had not as this section was excluded from his review. Mr. Schachter directed him to the section on page 32 titled "Establishment, Calculation and Collection of Sewer Service Charges." Mr. Schachter asked Mr. Webber if he recalled discussing this section with anyone, and he responded that he did not substantively review this section of the financial statements, he would just look for typographical errors. Mr. Dahlberg asked if the outside auditors were involved in the disclosure process and Mr. Webber responded that he did not interact with the outside auditors, apart from receiving from them the audited financial statements. Mr. Dahlberg asked if it was his general experience that disclosure counsel would not work with the outside auditors or if this procedure was unique to San Diego. Mr. Webber replied that, in general, auditors did not get into the day-to-day work on disclosure issues.

Proposition 218

Mr. Webber stated that in 1997 a new constitutional amendment, Proposition 218, was approved. This amendment imposed voter requirements for property-related fees. Mr. Webber stated that the terms used in this amendment were not well-defined, and it contained certain exemptions, which included sewers. In 1997, Mr. Webber strongly recommended that the City prepare new text for the disclosure documents and in the course of discussions that followed, made drafting suggestions and ultimately arrived at an acceptable format for the disclosure. The City disclosed that its rates were in compliance with 218, and assured Mr. Webber that the rates satisfied 218's proportionality requirement. Mr. Webber stated that Ms. Salt and Mr. Kahlie gave him this assurance. Mr. Schachter asked specifically whether these representations came from Mr. Kahlie and Ms. Salt, and Mr. Webber stated that they did.

Mr. Schachter directed Mr. Webber to an email from Ms. Salt dated October 18, 2001, responding to Mr. Kahlie's inquiries regarding the applicability of Proposition 218 to sewer rates (Exhibit 2). Mr. Schachter asked Mr. Webber if he recalled any discussion in 1999 regarding the need to disclose Proposition 218 compliance in offering documents. Mr. Webber responded that discussions were held because of the uncertainty of Proposition 218's

applicability to sewer rates. Mr. Schachter asked if, in 1999, anyone from the City told him that they believed Proposition 218 did not apply to sewer rates. Mr. Webber responded that if anyone told him this, they did not issue a formal opinion to this effect. Mr. Schachter asked if he recalled anyone opposing this disclosure, and he responded that he did not recall.

Orrick's Role in Negotiating SRF Loan Agreements

Mr. Webber was then shown a fax from Jenna Magan (Orrick) to Mr. Kahlie dated October 5, 1999, which transmitted an SRF loan contract with handwritten comments (Exhibit 3). Mr. Schachter asked Mr. Webber if he had reviewed any SRF agreements and Mr. Webber responded that he had, but only for the purpose of determining if they ran afoul of the structure of a given bond offering. Mr. Schachter asked if 1999 was the first year in which he reviewed an SRF agreement. Mr. Webber responded that he might have reviewed an SRF agreement in 1997, but was not certain because at that time he was also reviewing one that related to the water enterprise fund. He had previously reviewed one or more such agreements for the purpose of determining whether they ran afoul of the priority, debt capacity, or pledge provisions or the scope of the City's commitment to pay under bond offerings. He stated that he would not review the substantive issues of the representations or warranties of these agreements.

Mr. Schachter asked if Ms. Magan still worked at Orrick and Mr. Webber stated that she is a partner at Orrick specializing in public finance. Mr. Schachter asked what her purpose was in reviewing this document and Mr. Webber stated that it was the same as his. Mr. Schachter asked if she reviewed this document as a lawyer representing the City regarding this contract and Mr. Webber responded that her review was expressly not in that context. Mr. Schachter then asked if he discussed this document with her, and Mr. Webber replied that he would have discussed the scope of this review with her and gone over what she should have been looking for. Mr. Webber stated that priority was one issue with which Orrick would have been concerned; they would also have examined the State's view of the source of payment because in some contracts it was not limited to the enterprise fund. Orrick would also have been looking to determine if the pledge in the contract was different from that in the bond documents. Mr. Schachter directed Mr. Webber's attention to Section 11 of the contract and asked why Ms. Magan would have written to Mr. Kahlie "Should SWRCB acknowledge that City has already done this?" Mr. Webber replied that this was a signed contract. Mr. Schachter responded that the handwritten mark-ups seem to add to the contract and that it appeared to him that Ms. Magan was representing the City in entering into this contract. At this point in the interview, Mr. Garvey requested a break to confer with Mr. Webber.

After a short break, Mr. Garvey stated that Ms. Magan would be the best source of information on this topic. Mr. Webber stated that he believed this document to be an unsigned draft and Ms. Magan's role was to negotiate certain terms of the agreement, but the terms she negotiated were those dovetailing with the bond documents. He recalled that at one point, Orrick was trying to get the State to subordinate its debt to bondholders. Mr. Webber then sought to clarify his earlier comment by stating that Ms. Magan was negotiating for the City with respect to this contract, but her role was only to ensure that the negotiations did not run afoul of the bond documents.

Mr. Schachter asked again about Ms. Magan's comment on Section 11 and Mr. Webber stated that the contract as written provided that the City adopt an ordinance or resolution

prospectively. He stated that normally, there would have been a City Council Resolution to adopt the contract which would have specified a dedicated revenue source. Mr. Webber stated that his understanding of her comment was to ensure that the City was in agreement, before adoption of the contract, on exactly what revenue source was to be dedicated for this contract. Mr. Schachter asked if Ms. Magan had conversations with the City regarding the CWA, other loans or grants, or SWRCB approval, and Mr. Webber replied that he did not know. Mr. Schachter asked if he had conversations with the City on these topics and Mr. Webber replied that he did not.

Turning to Section 17 ("User Charge System") of Exhibit 3, Mr. Schachter asked Mr. Webber if he spoke to anyone at the City regarding this section. He replied that he did not, but that the language in this section was consistent with that in the disclosure documents. Mr. Schachter asked if he spoke to Ms. Magan about this section and he replied that he did not know. Mr. Schachter asked how the labor was divided in Orrick's representation of the City between Mr. Webber, Mr. Deaton, and Ms. Magan. Mr. Webber replied that Mr. Deaton joined Orrick's representation for the 2003 financing. Prior to that point, Ms. Magan was responsible for some drafting and assembling of documents. Mr. Webber stated that he led the discussions with Mr. Bromfield because he felt those discussions were a key part of the process, and he instructed Ms. Salt on the individuals he wished to speak to regarding litigations and other adversarial matters.

At this point in the interview, Mr. Webber clarified that when he used "litigations" earlier with regard to his conversations with Ms. Salt, he meant that to include adversarial matters. Ms. Schachter asked for the exact words Mr. Webber used and he responded that he asked if the City was engaged in any contests with the State for spills or any matters that could involve fines. He stated that he had explained he was not only looking for suits that had been filed, but also any regulatory actions.

Cost of Service Study

Mr. Webber was again shown Exhibit 2, and Mr. Schachter asked him if he knew about the COSS as of October 18, 2001. Mr. Webber responded that he did not, but that even if he had known, it would not have necessarily made him inquire further because the City was constantly having to adjust its rates for reasons other than proportionality. Mr. Schachter asked if Mr. Webber understood the term "Cost of Service Study," and he replied that he understood it to mean that the City had gone to an engineering firm to determine the rates necessary to support capital improvements and other expenditures. Mr. Schachter asked if Mr. Webber had heard of "COSS" as of October 18, 2001, and he responded that he did not recall hearing this term, or reacting to hearing it.

Mr. Schachter then noted that Ms. Salt wrote in this email, "we recommend that the City comply with the noticing provision," and asked if Mr. Webber recalled discussions regarding compliance with the noticing provisions of Proposition 218. Mr. Webber responded that he did not recall any such discussions and that the discussions he did recall regarded the need to comply with Proposition 218 so as not to jeopardize the rate increases that were otherwise needed. Mr. Schachter read that Ms. Salt wrote "[b]ond counsel has further advised us that we would have to disclose non-compliance with Prop 218," and asked if this sentence referred to Mr. Webber. He said it did. Mr. Webber recalled this discussion and stated that if he knew for certain (he noted that he did not) that the City was not in compliance and sewer charges

were a land-based fee, those rates would have been subject to challenge. He stated that if the applicability of Proposition 218 was that well-defined, the City would absolutely have had to disclose its non-compliance.

Mr. Schachter asked if he recalled a discussion about compliance with Proposition 218, as apart from the noticing provisions, and Mr. Webber responded that he only recalled discussions relating to notice. In these discussions, Mr. Webber told Ms. Salt that if Proposition 218 applied and the City did not comply with the notice provisions, it would need to disclose this information because there would not have been constitutionally-required predicates to the rate structure. Mr. Schachter asked what Mr. Webber would have done if she protested that the rates were compliant, and he responded that he did not recall any protest. This was before the *Shasta* case and Mr. Webber believed that other issuers were not in compliance with the notice provisions.

Returning to Exhibit 2, Mr. Schachter read that Mr. Kahlie wrote "I would expect that in the event that a discussion of the Cost of Service Study results...includes...changes in the rate structure...this event would also have to be noticed." He then asked if Mr. Webber recalled reading this passage, and Mr. Webber replied that he did not. Mr. Schachter asked if he recalled having an expectation that a COSS would recommend changes in the rate structure in January 2002. Mr. Webber responded that he did not recall having this expectation. Mr. Webber directed Mr. Schachter to the first paragraph of Mr. Kahlie's email, which discussed an increase of 7.5% in revenue, and stated that there was nothing here to suggest to him that there was an issue with rates. He stated that he read that the City wanted increases and wanted lifeline rates that might not have technically complied with Proposition 218 since they involved a subsidy. Mr. Schachter asked Mr. Webber if he was familiar with whether the lifeline would comply with the covenants of the City's federal loans, and he answered that he was not.

Mr. Dahlberg then directed Mr. Webber to the last sentence in the second paragraph of Exhibit 2 which reads "[t]his could also have a negative credit impact on the bonds." He asked Mr. Webber if he read this sentence to mean that every bad piece of information could have a negative impact or that Ms. Salt was giving more specific feedback that she did not want negative information in this issuance. Mr. Webber responded that he read this sentence to be referring to Proposition 218 and noted that the discussion of the lifeline would not have been a monumental issue. He stated that he did not read this sentence to be implying that there were serious compliance problems, and that no conversation alerted him to these problems until 2004. Mr. Dahlberg then asked if there was any "push-back" from the City regarding this issue, and Mr. Webber responded that he was not given any push-back prior to the blackout period (which begins on February 12, 2004). Mr. Dahlberg asked if he received any push-back during the entire 2003 financing. Mr. Webber stated that he did not recall any push-back on the issues he raised because they did not get to the heart of the issues with which the City was most concerned. He noted that Ms. Salt was not protesting the need to disclose Proposition 218 compliance, and if he discussed the lifeline he did not recall it. He observed that lifeline issues had arisen in other jurisdictions and probably did not comply with Proposition 218. Getting back to his earlier question, Mr. Dahlberg stated that he was trying to distinguish between usual comments from the City that the disclosure of bad information would have a negative credit impact and a desire not to disclose any bad information at all. Mr. Webber stated that this instance was an example of normal give and take without any special emphasis.

2003 Offering

Turning to the 2003 Offering, Mr. Schachter asked Mr. Webber what steps he took to determine whether the City had any regulatory problems that needed to be disclosed. Mr. Webber responded that he worked with Mr. Bromfield to prepare a draft of the regulatory requirements portion of the disclosure. These discussions took place over the phone, and most of Mr. Bromfield's changes were editorial and did not have substantive impact on the disclosure. Mr. Webber stated that he asked for an update of the CWA litigation, which belonged in a different section of the disclosure. He would next ask Mr. Bromfield if there were any additional regulatory requirements that the City should disclose. Mr. Webber stated that he did not specifically ask about federal requirements for proportional rates, but Mr. Bromfield told him that there were no additional issues that needed to be disclosed.

At this point in the interview, Mr. Schachter read from (but did not show Mr. Webber) page 7 of a memorandum dated November 30, 2004, which summarized an interview of Mr. Webber taken by Vinson & Elkins on November 18, 2004 (Exhibit 4). The section of the memorandum that Mr. Schachter read stated "The City had given certain related companies a rate holiday based on purported inability to pay. One of these was Kelco... Kelly Salt mentioned this to Mr. Webber in September 2003." Mr. Schachter asked Mr. Webber if he recalled Ms. Salt mentioning this issue to him in 2003, and Mr. Webber responded that he did not have this recollection and should have corrected that statement in the memorandum. Mr. Garvey stated that there was a conversation between Mr. Webber and Ms. Salt that occurred after February 12, 2004, but Mr. Webber was not permitted to discuss events that occurred after this date.

Mr. Webber stated that he had no recollection of receiving any communication from Ms. Salt or anyone else prior to February 12, 2004, regarding the relationship between rates and the covenants of loans and grants. He noted that if he had been told about a Cost of Service Study, this would not have triggered a question in his mind about a risk of losing loans or grants. Mr. Schachter asked if he recalled any discussions about a Cost of Service Study, and he replied that he did not recall because he would not have understood its significance. He knew that rate changes were needed to accommodate the financing and would have assumed the Cost of Service Study related to these changes.

Mr. Schachter asked whether, as of November 2003, anyone had told Mr. Webber that the City was not in compliance, and he responded that they had not. Mr. Schachter asked at what point during the September 2003 bond issuance procedure Mr. Webber would have expected the City to inform him of their non-compliance with loans and grants. Mr. Webber responded that he would have expected to hear of this issue when Mr. Bromfield updated the regulatory requirements section, or when Mr. Webber called him after he had made revisions to ask if there were additional disclosure issues. Mr. Webber again stated that Mr. Bromfield told him that there were no additional disclosure issues.

Mr. Schachter asked when Mr. Webber would have anticipated Mr. Kahlie to tell him about the City's non-compliance, and he responded that he would have expected to have been informed by Mr. Kahlie daily. Mr. Webber stated that he spoke to Mr. Kahlie almost daily during the 2003 financing. He stated that even the November 3, 2003 letter from the State did not cause Mr. Kahlie to discuss this issue with him. Mr. Schachter asked Mr. Webber if he ever

asked Mr. Kahlie about problems with the City's regulatory requirements and he responded that he did not recall asking Mr. Kahlie this question.

Mr. Schachter then asked Mr. Webber if he ever participated in the City's presentations to rating agencies. Mr. Webber responded that he did not, and did not know if the rating agencies asked any questions concerning rate compliance at these meetings. Mr. Schachter asked how far along the 2003 issuance progressed, and Mr. Webber responded that he received information at or around September 5, 2003, which gave him pause, so the process was stopped. Mr. Schachter asked if the POS had already been distributed by that time, and Mr. Webber responded that it had been distributed to prospective investors. Mr. Kahlie was in New York to price the offering, which meant that the sale was planned to occur the Monday or Tuesday following his visit.

Mr. Dahlberg asked if non-compliance with loans and grants was an issue that Mr. Kahlie would have recognized. Mr. Webber responded that the Aguirre Report made reference to a "Salient Points" memorandum authored by Mr. Kahlie, which clearly demonstrated that Mr. Kahlie understood these issues. Mr. Webber stated that Mr. Kahlie also knew that he was demanding with disclosure issues. Mr. Dahlberg noted that the City had already disclosed Proposition 218 issues by this point, and asked how much more information would have been contained in a disclosure section covering loan and grant non-compliance. Mr. Webber responded that a loan and grant non-compliance disclosure would have contained "not that much more" information than the Proposition 218 disclosure, and he stated that "one would have thought [the City] would have been willing to disclose" the loan and grant non-compliance.

Mr. Dahlberg asked if Ed Ryan was involved with the issue of loan and grant compliance, and Mr. Webber replied that he did not interact with Mr. Ryan on this issue, but surmised that he would have been aware of the City's non-compliance. Mr. Dahlberg asked if he spoke with Ms. Frazier about this issue, and Mr. Webber responded that he did not discuss with Ms. Frazier issues that did not relate to financial statements. Mr. Dahlberg asked if Mr. Hanley would have been aware of this issue, and Mr. Webber responded that Mr. Hanley would have understood this issue because he was concerned about the rate increases that were needed during this time.

Mr. Schachter asked Mr. Webber to explain the procedure by which the bonds would have been sold if the process had not been stopped. Mr. Webber explained that in an underwritten financing, the underwriters purchase the bonds and resell them to the public. This transaction is accomplished through a bond purchase contract that contains representations, warranties, conditions to closing, and a provision that states that the underwriters agree to buy and the issuer agrees to sell "x" bonds at "y" price. There are also representations and warranties about the adequacy of disclosure and "underwriter outs." The underwriters and the issuer set the pricing of the bonds. Prior to the pricing, both parties have a week or two to market the bonds to potential investors and the POS was used in this process, which contained all the information that the final OS would have contained except for price information. Mr. Webber noted that many investors who purchase tax-exempt securities (such as municipal bonds) are mutual funds. Mr. Webber stated that after the price agreement has been entered into, there remains little risk to the underwriters because they will have sold most of the bonds by this time. The deal closes when the bonds are delivered to the DTC (Depository Trust Company), and then to the bond trustee's

account. One physical certificate is delivered to the DTC and the rest of this transaction occurs electronically.

Mr. Dahlberg asked Mr. Webber for the point in the narrative he just described *when the 2003 Offering had progressed to before it was stopped*. Mr. Webber stated that the bonds were close to being priced when the City informed the underwriters that the transaction would be delayed. Mr. Schachter asked if it was the case that no one had agreed to purchase the bonds by this time and Mr. Webber responded that it was. Mr. Dahlberg asked Mr. Webber if information about the bonds had been disseminated to the public. Mr. Webber responded that the POS had been delivered to the rating agencies, broker-dealers, prospective buyers, and analysts who worked for these buyers.

Mr. Webber was next shown a draft of the 2003 POS, dated June 20, 2003 (Exhibit 5). Mr. Schachter asked Mr. Webber if he had a copy of the actual POS that was distributed and he responded that he did and would provide it to Mr. Schachter. Mr. Dahlberg asked if, when the City did not complete the Offering Statement, it was required to make a disclosure of this fact. Mr. Webber responded that the underwriters usually put out a message that the offering had been suspended, but in this case the underwriters still expected the deal to close. Mr. Webber stated that once the City finally decided that it would not go forward with this offering for at least a couple of months, he did not recall the underwriters clearly conveying this fact to the public.

Other Documents

Mr. Webber was shown, an email from Ms. Magan dated February 13, 2002, asking for updated disclosures from the San Diego Wastewater Group (Exhibit 6). Mr. Schachter asked Mr. Webber what disclosure this email referred to. Mr. Webber stated that February 13, 2002, would have been the Ballpark closing date, and that he did not know what disclosure this referred to. Mr. Schachter suggested it might have referred to an annual continuing disclosure. Mr. Webber replied that this was too early for those disclosures because work on them did not start until late March.

Mr. Webber was shown an email from Mary Vattimo dated February 27, 2003 (Exhibit 7). Mr. Schachter asked him for the subject matter of this email and he responded that it dealt with right-of-way fees. Mr. Webber recalled this issue coming to his attention in 1995. Mr. Schachter asked if he recalled this issue arising again in 2003 and he replied that he did not. Mr. Schachter asked Mr. Webber why the City would involve him in this issue. He responded that this email was around the time the 2003 financing started, and it would not have been unusual for the City to begin discussing certain issues internally before they arose in the context of a financing. Mr. Schachter then asked him to explain the relevance of this issue for a financing. Mr. Webber responded that it had a bearing on the propriety of transfers from the enterprise funds to the general fund. He stated that this was more of a general fund issue and that the federal authorities seemed to have "put this to bed" after the 1995 financing. During the 1995 financing, he raised the general issue of franchise fees and transfers because people wanted to take money from enterprise funds. The City told him at that time that the state had also raised this issue, but it did not arise again until the *Roseville* case.

Mr. Schachter asked if Mr. Webber opined on the right of way fees for the City and he responded that he did not. He also did not discuss whether this was a disclosure issue during the 2003 financing.

Mr. Webber was shown a letter from Ted Bromfield to Mr. Deaton dated June 3, 2003, containing Mr. Bromfield's revisions to a section of the POS (Exhibit 8). Mr. Schachter asked Mr. Webber if he reviewed this letter at the time it was sent, and he replied that he had. He stated that this was Mr. Bromfield's assignment once the OS was divided up, and noted that this was as formal as he remembered Mr. Bromfield's communications. Mr. Bromfield marked up the prior language from the 1999 deal and sent it to Orrick to review. Mr. Schachter asked if Mr. Webber had instructed him to do this, and he responded that he had and that they later discussed the changes Mr. Bromfield made. Mr. Schachter directed him to the second paragraph on page 3 of the document, and asked if he recalled any discussion with Mr. Bromfield about this paragraph or about the City's rate structure. Mr. Webber responded that he did not recall any such discussion. Mr. Schachter asked why Mr. Bromfield changed the word "annually" in that paragraph to "periodically," but Mr. Webber did not know. Mr. Schachter asked if Mr. Webber knew at the present time why this language was changed. He responded that certainly by 2003, the City was not reviewing service charges annually and instead reviewed them periodically. Mr. Webber referred to a chart on rate adjustments on page 36 of the 1999 OS (Exhibit 1) and stated that the rate changes are periodic and not annual.

Mr. Webber was shown a February 12, 2004 email from Paul Maco (Vinson & Elkins) replying to an earlier email from Mr. Webber which was entitled "FW: Punch List" (Exhibit 9). Mr. Schachter asked Mr. Webber for his recollection of first becoming aware of the rate compliance issue. Mr. Webber recalled that on the 9th or 10th of February 2004, he attended a Closed Session Council meeting where the City was "wringing [its] hands." By this time, Ed Ryan had resigned "out of the blue" and Councilmember Frye asked a question about the rate structure and compliance with loans and grants, but the Mayor cut her off. Mr. Webber stated that this event got his attention and he approached Councilmember Frye after the meeting and asked about her comments. She told him that there was an issue regarding non-compliance with loans and grants, and Mr. Webber told her that he would investigate this issue. Mr. Schachter asked what happened next, but Mr. Webber stated that he would not discuss matters that occurred after February 2004. Mr. Schachter asked if there was any other information Mr. Webber could discuss relating to this interaction with Councilmember Frye. Mr. Webber responded that her comments at this Council meeting were out of the blue, and triggered in his mind a concern that this non-compliance could put SRF and CWA loans in jeopardy.

Mr. Webber was shown an email from Ms. Salt dated February 13, 2003, which transmitted by way of attachment a November 14, 2002 memorandum from Ms. Vattimo and Ms. Salt regarding loan and grant compliance (Exhibit 10). Mr. Schachter asked if Mr. Webber had seen or heard of this email before February 12, 2004, and he responded that he had not.

Mr. Webber was shown an email from Mr. Kahlie to Mr. Girard dated March 5, 2004, discussing suggestions purportedly made by Mr. Webber regarding disclosure issues (Exhibit 11). Mr. Schachter asked Mr. Webber if, prior to February 12, 2004, he knew about the issue referenced in the email as the "Gann limit." Mr. Webber responded that he did not know about this issue at that time. Mr. Schachter asked him to explain the issue, and he responded that Gann was the name of the legislator who sponsored an amendment to Proposition 13 which

limited the loans that a public agency could receive in a given year. Mr. Schachter asked, hypothetically, how the Gann limit would be implicated by undercharging a business. Mr. Garvey instructed Mr. Webber not to answer this question. Mr. Webber suggested that Mr. Girard might feel that he has a different privilege waiver and would be a good source of information on this issue. Mr. Schachter then asked Mr. Webber if, at any time before his conversation with Ms. Frye in February 2004, he examined the sentence in the wastewater disclosure documents which indicated that no grants had been disallowed. He responded that, at that time, he "took it at face value," but that he saw more significance to that sentence after February 12, 2004.

Mr. Webber was shown the City's continuing disclosure statement dated March 26, 2004 (Exhibit 12). Mr. Schachter asked if the timing of the release of this document was normal or if this disclosure was made specifically to highlight the issues contained therein. Mr. Webber responded that this was the normal timing for the City's continuing disclosure statements. Mr. Schachter asked why this disclosure took so long to be released, and Mr. Garvey indicated that Mr. Webber could not answer that question due to privilege concerns. Mr. Schachter referred Mr. Webber to the sentence in this disclosure which indicates that over the last 16 years, the City has attempted to bring their rates into compliance with SWRCB requirements. Mr. Schachter asked if Mr. Webber learned of these efforts from a non-privileged source, and Mr. Webber responded that he did not. Mr. Schachter asked if, prior to February 12, 2004, he was aware if the City had attempted to comply with the SWRCB regulations for the prior sixteen years, and he responded that he was not.

Mr. Webber was shown a memorandum from Mary Vattimo to Les Girard dated May 18, 2004, regarding the City's disclosure practices (Exhibit 13). Mr. Schachter asked if Mr. Webber had ever seen this memorandum, and he replied that he had not.

Conclusion - Remediation

Mr. Schachter asked Mr. Webber, given his understanding at this point, if he believed that the City intentionally withheld information concerning non-compliance with loans and grants, or that this was an oversight. Mr. Webber asked for a break to confer with Mr. Garvey. After a short break, Mr. Garvey stated that Mr. Webber would not answer questions on this topic. Mr. Schachter asked if there was anything else, factual in nature, related to the issues so far discussed that had not been covered in this interview. Mr. Garvey stated that in the City's revolving loan agreements, there was an unequivocal representation concerning rate compliance. Mr. Schachter then asked if Mr. Webber knew of any facts, or had any experiences or insights into the personalities of relevant individuals that would be relevant to assessing the issues discussed in this interview. Mr. Webber responded that in the City Attorney's Report there was mention of Councilmember Kehoe's request for an opinion on Proposition 218. In addition, Mr. Webber suggested that one could compare statements attributable to the Mayor in May 2002 with City Council minutes from January 2002 regarding consideration of a Cost of Service Study.

Mr. Schachter clarified that his question was whether anyone put those issues together with the need to disclose. He asked if it was possible that the compliance issues were compartmentalized in individuals' minds from disclosure responsibilities. Mr. Garvey stated that Mr. Webber would not comment about others' thoughts. Mr. Schachter asked if there were any

facts or experiences that would shed light on this issue, and Mr. Webber responded that there was nothing tangible he could point out.

Mr. Schachter asked again if there was any additional information relevant to the topics thus far discussed that had not been discussed in this interview. Mr. Webber responded that in the City's voluntary disclosure there was a statement that the City believed it complied with Proposition 218, and that the City had not received an opinion from the City Attorney's Office on this matter. Mr. Webber suggested that one could compare that statement with Councilmember Kehoe's request for factual accuracy.

Mr. Dahlberg asked if Mr. Webber had any suggestions about how to fix the City's disclosure process. Mr. Webber responded that one could read the V&E Report and that the big picture issue was that there was no accountability for any disclosure documents. Mr. Garvey stated that Mr. Webber would not comment further on this question.

Follow-up Phone Conversation (May 15, 2006)

Mr. Schachter began this call by stating that he wanted to further discuss the City Council's role in the approval of bond offerings. Mr. Romano stated that the Council approved bonds "as to form" by Resolution and then authorized the City to close on the bond offering on satisfaction of the conditions stated in the Resolution. Mr. Romano asked Mr. Webber to explain the next step in the process after the Council authorized the City to enter into a bond offering agreement. Mr. Garvey then asked if the Council received the POS at that time. Mr. Romano replied that the Council did have the POS, but it is only in preliminary form and additional information needs to be added. Mr. Romano asked Mr. Webber if his foregoing explanation of the Council's process was accurate, and Mr. Webber stated that he did not believe so.

Mr. Webber stated that, generally, the Council would receive a "pretty complete version" of the POS. While there were additional steps that needed to be taken before the offering was completed, the Council would have received a substantially complete version of the offering and disclosure documents. Mr. Webber stated that he would have been uncomfortable giving the Council only a "skeleton" document before entering into a bond offering.

Mr. Webber explained that the Council voted on whether to authorize the City to complete the bond offering and authorized the City's staff to make necessary changes to the documents. Mr. Webber stated that if the bond offering changed post-authorization, he would have gone back to the Council for an additional authorization. He explained that for the disclosure documents, which did not include pricing information, the Council approved the documents "with such changes as management authorizes." He noted again that if intervening material facts were to occur between the authorization and the closing, he would have wanted to return to the Council for an additional approval. Mr. Webber stated that it was not fair to say that "everything was done on the staff level," since documents were sent to the Council for its review.

Mr. Webber then stated that he forgot to mention in his earlier interview that prior to the Voluntary Disclosure in January 2004, he spoke on the phone with Mr. Kahlie and Ms. Webster and asked if there was anything additional related to disclosure that he should focus on because he had a feeling that there might be something that would later come back to haunt the

City. Mr. Webber stated that he had separate phone calls with Mr. Kahlie and Ms. Webster and that both of them replied that there were no additional issues related to disclosure.

Mr. Webber also stated that Mr. Kahlie did not inform him of the November 2003 letter from the SWRCB to the City in which the SWRCB stated that it did not have documentation supporting the proportionality of the City's rates. Mr. Romano asked if Mr. Webber had any documentation that helped him remember these conversations and Mr. Webber responded that he did not, aside from perhaps a scribbled note. Mr. Webber explained that the issue of rates did not come up in a meaningful way during the preparation of the Voluntary Disclosure. He noted that the wastewater section of the Voluntary Disclosure focused on errors in past financial statements.

Mr. Schachter asked if the fact that rates did not arise during the Voluntary Disclosure procedure partly explained the delay in disclosing the City's non-compliance until March 27, 2004. Mr. Garvey stated that he would need to consult the City's privilege waiver before allowing Mr. Webber to answer that question. Mr. Garvey noted that Mr. Webber has given the City all of his documents regarding Orrick's representation of the City.

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